MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Jump to the transcript of the questions and answers

Good afternoon, the Vice-President and I welcome you to our press conference.

At today's meeting, the Governing Council focused on two main topics: first, the implications of our strategy review for our forward guidance on the key ECB interest rates; and, second, our assessment of the economy and our pandemic measures.

In our recent strategy review, we agreed a symmetric inflation target of two per cent over the medium term. Our policy rates have been close to their lower bound for some time and the medium-term outlook for inflation is still well below our target. In these conditions, the Governing Council today revised its forward guidance on interest rates. We did so to underline our commitment to maintain a persistently accommodative monetary policy stance to meet our inflation target.

In support of our symmetric two per cent inflation target and in line with our monetary policy strategy, the Governing Council expects the key ECB interest rates to remain at their present or lower levels until we see inflation reaching two per cent well ahead of the end of our projection horizon and durably for the rest of the projection horizon, and we judge that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target.

Let me turn to the assessment of the economic outlook and our pandemic measures.

The recovery in the euro area economy is on track. More and more people are getting vaccinated, and lockdown restrictions have been eased in most euro area countries. But the pandemic continues to cast a shadow, especially as the delta variant constitutes a growing source of uncertainty. Inflation has picked up, although this increase is expected to be mostly temporary. The outlook for inflation over the medium term remains subdued.

We need to preserve favourable financing conditions for all sectors of the economy over the pandemic period. This is essential for the current rebound to turn into a lasting expansion and to offset the negative impact of the pandemic on inflation. Therefore, having confirmed our June assessment of financing conditions and the inflation outlook, we continue to expect purchases under the pandemic emergency purchase programme (PEPP) over the current quarter to be conducted at a significantly higher pace than during the first months of the year.

We also confirmed our other measures to support our price stability mandate, namely the level of the key ECB interest rates, our purchases under the asset purchase programme (APP), our reinvestment policies and our longer-term refinancing operations, as detailed in the press release published at 13:45

today. We stand ready to adjust all of our instruments, as appropriate, to ensure that inflation stabilises at our two per cent target over the medium term.

I will now outline in more detail how we see the economy and inflation developing, and then talk about our assessment of financial and monetary conditions.

Economic activity

The economy rebounded in the second quarter of the year and, as restrictions are eased, is on track for strong growth in the third quarter. We expect manufacturing to perform strongly, even though supply bottlenecks are holding back production in the near term. The reopening of large parts of the economy is supporting a vigorous bounce-back in the services sector. But the delta variant of the coronavirus could dampen this recovery in services, especially in tourism and hospitality.

As people return to shops and restaurants and resume travelling, consumer spending is rising. Better job prospects, increasing confidence and continued government support are reinforcing spending. The ongoing recovery in domestic and global demand is boosting optimism among businesses. This supports investment. For the first time since the start of the pandemic, our bank lending survey indicates that funding of fixed investment is an important factor driving the demand for loans to firms.

We expect economic activity to return to its pre-crisis level in the first quarter of next year. But there is still a long way to go before the damage to the economy caused by the pandemic is offset. The number of people in job retention schemes has been declining but remains high. Overall, there are still 3.3 million fewer people employed than before the pandemic, especially among the younger and lower skilled.

Ambitious, targeted and coordinated fiscal policy should continue to complement monetary policy in supporting the recovery. In this context, the Next Generation EU programme has a key role to play. It will contribute to a stronger and uniform recovery across euro area countries. It will also accelerate the green and digital transitions and support necessary structural reforms that lift long-term growth.

Inflation

Inflation was 1.9 per cent in June. We expect inflation to increase further over the coming months and to decline again next year. The current increase is largely being driven by higher energy prices and by base effects from the sharp fall in oil prices at the start of the pandemic and the impact of the temporary VAT reduction in Germany last year. By early 2022, the impact of these factors should fade out as they fall out of the year-on-year inflation calculation.

In the near term, the significant slack in the economy is holding back underlying inflationary pressures. Stronger demand and temporary cost pressures in the supply chain will put some upward pressure on prices. But weak wage growth and the past appreciation of the euro mean that price pressures will likely remain subdued for some time.

There is still some way to go before the fallout from the pandemic on inflation is eliminated. As the economy recovers, supported by our monetary policy measures, we expect inflation to rise over the medium term, although remaining below our target. While measures of longer-term inflation expectations have increased, they remain some distance from our two per cent target.

Risk assessment

We see the risks to the economic outlook as broadly balanced. Economic activity could outperform our expectations if consumers spend more than currently expected and draw more rapidly on the savings they have built up during the pandemic. A faster improvement in the pandemic situation could also lead to a stronger expansion than currently envisaged. But growth could underperform our expectations if the pandemic intensifies or if supply shortages turn out to be more persistent and hold back production.

Financial and monetary conditions

The recovery of growth and inflation still depends on favourable financing conditions. Market interest rates have declined since our last meeting. Financing conditions for most firms and households remain at favourable levels.

Bank lending rates for firms and households remain historically low. Firms are still well funded as a result of their borrowing in the first wave of the pandemic, which in part explains why lending to firms has slowed. By contrast, lending to households is holding up. Our most recent bank lending survey shows that credit conditions for both firms and households have stabilised. Liquidity remains abundant.

At the same time, the cost for firms of issuing equity is still high. Many firms and households have taken on more debt to weather the pandemic. Any worsening of the economy could therefore threaten their financial health, which could trickle through to the quality of banks' balance sheets. It remains essential to prevent balance sheet strains and tightening financing conditions from reinforcing each other.

Conclusion

Summing up, the euro area economy is rebounding strongly. But the outlook continues to depend on the course of the pandemic and progress with vaccinations. The current rise in inflation is expected to be largely temporary. Underlying price pressures will likely increase gradually, although leaving inflation over the medium term still well below our target. Our policy measures, including our revised forward guidance, will help the economy shift to a solid recovery and, ultimately, bring inflation to our two per cent target.

We are now ready to take your questions.

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Could you run me through your discussion on changing the forward guidance? We hear that you couldn't get unanimity on the guidance two weeks ago. Did that happen today? Was the forward guidance supported unanimously or was there dissent? How is this guidance different than what you discussed two weeks ago?

Second question is about the Delta variant, which you mentioned a couple of times: we know it's more contagious and UK infection numbers are rising quite rapidly. Do you see a risk that the emergency phase of the pandemic will last longer than now many think because of Delta? Is Delta properly factored into your risk assessment?

Lagarde: Well, I will need at least an hour to go through all your questions! You cover huge ground, so let me tackle your first question, which had to do with how we reached our decision in relation to forward guidance. Let me take you back just a little bit to our strategy review and the strategy – the monetary policy strategy that we adopted unanimously. You have to think in terms of the strategy that we adopted as the framework within which we weave monetary policy. There was unanimity on the framework. This is really the basis against which we develop monetary policy as we go, and depending on circumstances, so unanimity there.

There was unanimous agreement around the table that we had to revise our forward guidance, and that forward guidance had to implement our strategy review. We did not have unanimity, but we had an overwhelming majority about the calibration of the forward guidance on ECB interest rates. That's what I had anticipated and what matters most is the fact that directionally, we were all on the same page and determined to revise the forward guidance as we did, but also to make sure that it is geared to implement our strategy. So that's very bluntly how it happens and what matters really is this chain of events, if you will, amongst us.

Now, you asked me to dissect the forward guidance that we adopted, and if you don't mind, I am going to take you through a little exercise of going through that long sentence, which is probably the one that is a little bit more lengthy in the whole presentation that I gave you. It's a bit more lengthy because the forward guidance rests on three key criteria, if you will, or three legs of forward guidance. I will take you through that. First of all, in support of our symmetric 2% inflation target and in line with our monetary policy strategy, so we are well anchored in our strategy. We remind ourselves that we are targeting 2% inflation and our commitment is symmetric. The Governing Council, so it is not relying on any kind of projections. It is the Governing Council in its judgement that expects the key ECB interest rates to remain at their present or lower levels until – and that's when it begins to be important – we see inflation reaching 2% well ahead of the end of our projection horizon. That's leg number 1.

Leg number 2: durably for the rest of the projection horizon and, third leg, we judge that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at 2% over the medium term. We add to that a sentence that you might remember from the strategy review, which is: this may also imply a transitory period in which inflation is moderately above target. So, by these three legs we are essentially saying, first of all, that we want to see inflation reach 2[1]% well ahead of the end of our projection horizon. Now, you might say, what is well ahead? Well ahead first of all is determined by judgement of the Governing Council but it is essentially the midpoint in our overall horizon.

Just to remind those of you who do not necessarily know what our projection horizon is, at the moment we project '21, '22, '23. So, we want to see at least 2% on the horizon, but well ahead of the end of this horizon. The second aspect is that we want that 2% to be durable, so we want it – and that's the second part of the statement – it says: durably for the rest of the projection horizon. So, it can oscillate a little bit but it cannot go below 2%, essentially. The third one, which is important as well, is that we want to look at the current circumstances and in particular the current underlying inflation, to see whether directionally these underlying inflation components actually lead us into that upward trend that will help us reach the 2% target that we are committed to. So you've got three legs: one that is in the present, you could argue that there is an element of outcome based in that one, where we look at the